

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Rules to Ensure Reliable, Long-Term Supplies of Natural Gas to California.	Rulemaking 04-01-025 (Filed January 22, 2004)
Order Instituting Rulemaking to Require California Natural Gas and Electric Utilities to Preserve Interstate Pipeline Capacity to California.	Rulemaking 02-06-041 (Filed June 27, 2002)
In the Matter of the Application of Southern California Gas Company Regarding Year Six (1999-2000) Under Its Experimental Gas Cost Incentive Mechanism and Related Gas Supply Matters. (U 904 G)	Application 00-06-023 (Filed June 15, 2000)
In the Matter of the Application of San Diego Gas and Electric Company (U 902 G) to Modify and Extend Permanent Gas Procurement Performance-Based Ratemaking Mechanism.	Application 02-10-040 (Filed October 31, 2002)

**ADMINISTRATIVE LAW JUDGE'S RULING
REGARDING PETITIONS OF PACIFIC GAS AND ELECTRIC COMPANY,
SOUTHERN CALIFORNIA GAS COMPANY, AND
SAN DIEGO GAS & ELECTRIC COMPANY FOR AUTHORITY TO BE
RELIEVED OF RISK FROM NATURAL GAS HEDGING PURCHASES**

Summary

This ruling directs Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SoCalGas), and San Diego Gas & Electric Company

(SDG&E) to respond to a number of questions relating to their respective proposals to be relieved of liability for the costs of hedging instruments for natural gas. Each utility proposal is included in petitions to modify decisions issued in these dockets. PG&E filed a petition to modify Decision (D.) 04-01-047 and D.05-10-015 on May 5, 2006. SDG&E filed a petition to modify D.03-07-037 and D.05-10-043 on May 17, 2006. SoCalGas filed a petition to modify D.05-10-043 on May 17, 2006.

This ruling also schedules an evidentiary hearing to clarify the utility proposals, address possible alternatives, the risks that ratepayers would assume and the impacts of last winter's hedging activities. Finally, this ruling resolves several procedural motions made by the utilities.

Background

These petitions of PG&E, SoCalGas, and SDG&E request modifications to recent orders addressing their respective risk-sharing mechanisms for the purchase of natural gas. Those mechanisms are referred to as the "Core Procurement Incentive Mechanism," "Gas Cost Incentive Mechanisms" (GCIM), and "Gas Procurement Performance Based Ratemaking (PBR) Mechanisms." The utilities state these ratemaking mechanisms do not provide adequate incentive for purchasing natural gas hedging instruments. Hedging in this context refers generally to financial instruments that are purchased as insurance against market price spikes.

Last October, the Commission issued D.05-10-015 and D.05-10-043, which approved short term hedging for all three gas utilities following Hurricane Katrina and in anticipation of dramatic increases in market gas prices. The Commission allowed each utility to purchase hedged instruments outside of their respective gas purchase incentive mechanisms in consideration of the

higher level of risk presented by hedging financial instruments. This regulatory authority is significant because it assigned all risk and costs associated with hedging to utility core ratepayers.

The petitions to modify filed in these dockets seek expedited action, stating generally that the Commission must provide flexibility to the utilities to purchase hedging products soon in order to mitigate the risk of price spikes this winter.

Questions for Utility Responses

The petitions filed by the utilities do not provide adequate information to justify the authority the utilities seek. Accordingly, PG&E, SoCalGas, and SDG&E shall respond to the following questions in writing no later than June 5, 2006 and shall present a witness to explain those responses at a hearing on June 9, 2006. Each response shall identify the witness responsible for the response.

1. Provide information about total spending on hedging instruments for natural gas, as authorized by D.05-10-015 and D.05-10-043, the amount of core gas that was hedged and the associated savings or losses associated with those purchases;
2. Provide the same information as requested in Question 1 for hedging activities over the past five years;
3. With regard to the purchases described in Questions 1 and 2, describe how the utility determined the amount of core gas to be hedged;
4. Provide information about total spending on hedging instruments, if any, since the end of the winter season;
5. If the utility lost money from hedging strategies during the last winter season, explain why this occurred and why purchasing hedging instruments this year presents a lower risk of loss;

6. Describe specifically the types of hedging instruments the utilities might purchase and how they operate;
7. Describe how engaging in hedging provides an appropriate incentive for the utility to procure least-cost gas supplies;
8. Explain why hedging is too risky for shareholders to assume some liability for losses but is not too risky for ratepayers. Is there any potential for utility gains under existing gas purchase incentive mechanisms and if there are, why does the utility believe those regulatory mechanisms present unacceptable risks for hedging financial products;
9. Explain why hedging natural gas products promotes ratepayer interests better than purchasing natural gas for storage or purchasing natural gas in the spring, summer and fall months contracts for delivery during the winter season whether as part of existing incentive mechanisms or outside of them;
10. Explain the Commission's authority to approve retroactive recovery of a utility expenditure with reference to specific statutes or case law;
11. Explain the process used to assure least-cost and safe purchases of hedging instruments on behalf of ratepayers;
12. Explain the expertise the utility has to purchase complex financial instruments and the methods for analyzing the associated risks;
13. Explain how the utility determines the creditworthiness of the counterparties from whom it purchases hedging instruments and how it selects the counter parties to its hedging instruments;
14. Explain whether and how the Commission should conduct after-the-fact reasonableness reviews of the utilities' hedging practices conducted pursuant to these petitions;

15. Evaluate the reasons for or against some type of risk sharing for hedged products -- for example, an equal sharing of profits and losses between shareholders and ratepayers -- in order to provide the utility with an incentive to make the best decisions on behalf of ratepayers.

Motions to File Under Seal

PG&E, SoCalGas, and SDG&E all filed motions asking the Commission to file certain confidential information under seal. No party objected to the motions. This ruling grants the motions of each utility to file confidential information under seal. The Commission is nevertheless within its authority to publish or otherwise disclose any information it determines should be disclosed on behalf of the public interest. Each utility shall provide relevant information to parties to this proceeding who agree to maintain the confidentiality of the information as set forth herein.

Motions for Protective Order

PG&E, SoCalGas, and SDG&E each filed a motion asking the Commission to issue a ruling with a protective order that would be used for the review of sensitive information. Consistent with prevailing Commission practice, the Commission will rely on the parties to meet and confer and then craft a mutually-acceptable nondisclosure agreement that may be used during the discovery process. The Commission may decide to arbitrate any disputes that may arise during discovery. This ruling denies the motions for protective orders.

Motions for Shortening Response Times

All three petitions to modify seek shortened deadlines for parties to file responses. PG&E seeks responses three weeks from the date of filing and a Commission decision by June 15. SDG&E and SoCalGas seek responses 18 days

after filing and a Commission decision by June 29. The utilities' proposed schedules would require the Commission to issue orders less than a month from the proposed deadlines for parties' responses.

Public Utilities Code Section 311(g)(1) requires the Commission to publish proposed decisions for 30 days before issuing a final order. Section 311(g)(2) permits the Commission to waive or reduce this 30-day period only in the event of an "unforeseen emergency situation."¹ The utilities do not make a compelling case that an emergency exists and none argue that the emergency they invoke is "unforeseen." PG&E states a need for urgent action because of the impending hurricane season, a fact that is well known and certainly not "unforeseen." SDG&E and SoCalGas make similar arguments, presenting no information that is recently discovered and no argument that they would be unable to purchase gas supplies or financial instruments without a Commission order. Indeed, the utilities do not need a Commission order to purchase natural gas supplies or financial instruments. The petitions ask only that the Commission relieve them of liability for those purchases and to do so retroactively. Moreover, although the utilities ask the Commission and parties to forego the usual period for review, comment and drafting a Commission order, the utilities themselves put off filing these petitions for seven months after the issuance of the decisions they would modify, knowing during that time that they would require the Commission authority they seek.

¹ Section 311(g)(2) also permits the Commission to waive the 30-day publication of a proposed decision "upon stipulation of all parties to the proceeding, for an uncontested matter in which the decision grants the relief requested, or for an order seeking temporary injunctive relief." None of these conditions exist at this time.

The utility petitions propose broad and virtually unconditional authority to make investments that involve significant financial risk, and they ask that all of that risk be assumed by their ratepayers. In order to provide that authority, the Commission must have a supporting record and provide a reasonable opportunity for the participation of parties representing other interests. This ruling therefore denies the motions to shorten the deadlines for filing responses to the petitions to modify and does not commit to issuing a June order on the basis of the information provided in the petitions. The Commission may issue an order in June, as the utilities propose, if circumstances arise that permit it to shorten the 30-day comment period, consistent with Section 311(g)(2).

The Commission appreciates the expeditious work of TURN and DRA, which filed responses to PG&E's petition on May 26, as PG&E requested.

Status of Dockets

The three petitions to modify seeking authority for relief from liability for hedging were filed in a total of four dockets because related decisions were issued in those dockets. The Commission does not consolidate these dockets for purposes of addressing the petitions and intends to close each docket that is not otherwise active with the issuance of a decision or decisions resolving the pending petitions.

Evidentiary Hearing

The Commission hereby schedules an evidentiary hearing for June 9, 2006 at 10 a.m. in the Commission's San Francisco Hearing Room, 505 Van Ness Avenue, San Francisco. The purpose of the hearing is to provide an opportunity for parties and the administrative law judge to clarify written utility responses to questions posed by this ruling and to inquire as to any other relevant issue. Any party wishing to cross-examine a utility witness at the hearing shall, no later than

June 7, 2006, send an electronic message to the ALJ and all parties that describes the subjects for cross-examination and provides an estimate of cross-examination time. The Commission does not intend to carry-over the hearing to a later date.

IT IS RULED that:

1. The respective motions of PG&E, SDG&E, and SoCalGas to shorten the deadlines for responses to their petitions are denied.
2. The respective motions of PG&E, SDG&E, and SoCalGas to file confidential portions of their petitions under seal are granted as set forth herein.
3. The respective motions of PG&E, SDG&E, and SoCalGas for protective orders are denied as set forth herein.
3. PG&E, SDG&E, and SoCalGas shall, no later than June 5, 2006, serve responses to the questions presented herein.
4. The Commission hereby schedules a hearing in this proceeding for June 9, 2006, at 10 a.m. in the Commission's San Francisco Hearing Room.
5. Parties wishing to cross-examine witnesses shall notify the undersigned ALJ and all parties of their plans as set forth herein.

Dated May 30, 2006, at San Francisco, California.

/s/ KIM L. MALCOLM

Kim L. Malcolm
Administrative Law Judge

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Administrative Law Judge's Ruling Regarding Petitions of Pacific Gas and Electric Company, Southern California Gas Company, and San Diego Gas & Electric Company for Authority to be Relieved of Risk from Natural Gas Hedging Purchases on all parties of record in this proceeding or their attorneys of record.

Dated May 30, 2006, at San Francisco, California.

/s/ TERESITA C. GALLARDO
Teresita C. Gallardo

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.